United Nations A/CN.9/WG.I/WP.88

General Assembly

Distr.: Limited
27 January 2015

Original: English

United Nations Commission on International Trade Law
Working Group I (MSMEs)
Twenty-fourth session
New York, 13-17 April 2015

Annotated provisional agenda

I. Provisional agenda

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of legal standards in respect of micro, small and medium-sized enterprises (Legal questions surrounding the simplification of incorporation).
5. Other business.
6. Adoption of the report.

II. Composition of the Working Group

1. The Working Group is composed of all States members of the Commission, which are the following: Algeria (2016), Argentina (2016), Armenia (2019), Australia (2016), Austria (2016), Belarus (2016), Botswana (2016), Brazil (2016), Bulgaria (2019), Cameroon (2019), Canada (2019), China (2019), Colombia (2016), Côte d'Ivoire (2019), Croatia (2016), Denmark (2019), Ecuador (2019), El Salvador (2019), Fiji (2016), France (2019), Gabon (2016), Georgia (2015), Germany (2019), Greece (2019), Honduras (2019), Hungary (2019), India (2016), Indonesia (2019), Iran (Islamic Republic of) (2016), Israel (2016), Italy (2016), Japan (2019), Jordan (2016), Kenya (2016), Kuwait (2019), Liberia (2019), Malaysia (2019), Mauritania (2019), Mauritius (2016), Mexico (2019), Namibia (2019), Nigeria (2016), Pakistan (2016), Panama (2019), Paraguay (2016), Philippines (2016), Poland (2016), Republic of Korea (2019), Russian Federation (2019), Sierra Leone (2019), Singapore (2019), Spain (2016), Switzerland (2019), Thailand (2016),

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Turkey (2016), Uganda (2016), United Kingdom of Great Britain and Northern Ireland (2019), United States of America (2016), Venezuela (Bolivarian Republic of) (2016) and Zambia (2019). The term of the membership expires on the last day prior to the beginning of the annual session of the Commission in the year indicated in parentheses.

2. States not members of the Commission and international governmental organizations may attend the session as observers and participate in the deliberations. In addition, invited international non-governmental organizations may attend the session as observers and represent the views of their organizations on matters where the organization concerned has expertise or international experience so as to facilitate the deliberations at the session.

III. Annotations to agenda items

Item 1. Opening of the session

3. The twenty-fourth session of Working Group I is scheduled to be held at the United Nations Headquarters in New York from 13 to 17 April 2015. Meeting hours will be from 10:00 a.m. to 1:00 p.m. and from 3:00 p.m. to 6:00 p.m., except on Monday, 13 April 2015, when the session will commence at 10:30 a.m.

Item 2. Election of officers

4. In accordance with its practice at previous sessions, the Working Group may wish to elect a Chair and a Rapporteur.

Item 4. Preparation of legal standards in respect of micro, small and medium-sized enterprises (Legal questions surrounding the simplification of incorporation)

1. Background information

5. At its forty-second session, in 2009, the Commission requested the Secretariat to prepare a detailed study including an assessment of the legal and regulatory issues at stake in the field of microfinance. The study was also to include proposals as to the form and nature of a reference document discussing the various elements required to establish a favourable legal framework for microfinance, which the Commission might in future consider preparing with a view to assisting legislators and policymakers around the world.[1]

6. The study, discussed at the forty-third session of the Commission, in 2010, considered the role of microfinance in poverty alleviation and achievement of the Millennium Development Goals by facilitating access to financial services for the poor who were not served by the formal financial system. On the understanding that an appropriate regulatory environment would contribute to the development of the microfinance sector, the Commission agreed that the Secretariat should convene a colloquium, with the possible participation of experts from other organizations working actively in that field, to explore the legal and regulatory issues surrounding

[1] *Official Records of the General Assembly, Sixty-fourth Session, Supplement No. 17* (A/64/17), paras. 432-433.

microfinance that fell within the mandate of UNCITRAL. The colloquium was to result in an official report outlining the issues at stake and containing recommendations on work that UNCITRAL might usefully undertake in the field.[2]

7. The colloquium, held in January 2011, resulted in a number of findings.[3] Despite some successful initiatives at the national level, there was no coherent set of global legal and regulatory measures that could serve as a standard for international best practice. Many States were struggling to find an appropriate regulatory framework to promote financial inclusion (the more current term for "microfinance"), and it was suggested that UNCITRAL could make a substantial contribution in this regard. Several issues were identified for future consideration,[4] of which the Commission, at its forty-fourth session, in 2011, chose the following for in-depth study by the Secretariat: (i) overcollateralization and the use of collateral with no economic value; (ii) e-money, including its status as savings; whether "issuers" of e-money were engaged in banking and hence what type of regulation they were subject to; and the coverage of such funds by deposit insurance schemes; (iii) provision for fair, rapid, transparent and inexpensive processes for the resolution of disputes arising from microfinance transactions; and (iv) facilitating the use of, and ensuring transparency in, secured lending to microenterprises and small and medium-sized enterprises. At that session, the Commission also agreed to include microfinance as an item for its future work.[5]

8. The study,[6] submitted at the forty-fifth session of the Commission, in 2012, provided a brief summary of the state of the matter in each of the four topics indicated above, as well as key legal and regulatory issues relating thereto, for consideration by the Commission. Following discussion, the Commission agreed to hold one or more colloquia on microfinance and related matters, as a matter of priority, with a focus on: facilitating simplified business incorporation and registration; access to credit for micro-businesses and small and medium-sized enterprises; dispute resolution applicable to microfinance transactions; and other topics related to creating an enabling legal environment for micro-businesses and small and medium-sized enterprises.[7]

9. The second colloquium on microfinance was held in Vienna in January 2013 with the participation of experts from all over the world including specialists from governments, international organizations, non-governmental organizations, the private sector and academia. The following topics were discussed: the enabling environment for micro, small and medium-sized enterprises (MSMEs) and the rule of law; incorporation and registration of micro-borrowers; effective alternative dispute resolution mechanisms for MSMEs; enabling legal environment for mobile

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[2] Ibid., *Sixty-fifth Session, Supplement No. 17* (A/65/17), paras. 274-280.

[3] See A/CN.9/727.

[4] Ibid., see para. 56.

[5] *Official Records of the General Assembly, Sixty-sixth Session, Supplement No. 17* (A/66/17), paras. 241-246.

[6] See A/CN.9/756.

[7] *Official Records of the General Assembly, Sixty-seventh Session, Supplement No. 17* (A/67/17), paras. 124-126.

payments; legal issues surrounding access to credit for MSMEs; and insolvency and winding up of MSMEs.[8]

10. At its forty-sixth session, in 2013, the Commission took note of the broad consensus among participants at the colloquium to recommend that a Working Group be established to address the legal aspects of establishing such an enabling environment for MSMEs. Participants in the January 2013 colloquium identified five broad areas where it was thought the Commission could provide guidance, to be articulated so as to address the business cycle of MSMEs.[9] The starting point could be guidance that allowed for simplified business start-up and operating procedures. Other topics to be taken up subsequently could include the following: (i) a system for resolving disputes between borrowers and lenders, including taking into account possibilities for the use of online dispute resolution; (ii) effective access to financial services for MSMEs, including consideration of broadening the scope of UNCITRAL's existing instruments on e-commerce and international credit transfers to accommodate mobile payment systems; (iii) guidance on ensuring access to credit, addressing issues such as transparency in lending and enforcement in a range of lending transactions and; (iv) insolvency of MSMEs, aimed at fast-track procedures and business rescue options so as to develop workable alternatives to formal insolvency processes in line with both the key characteristics of an effective insolvency system and the needs of MSMEs. UNCITRAL's existing instruments as well as guidance already developed by international organizations were said to be suitable building blocks for work in these areas. As to the form the Commission guidance could take, the Commission was further advised that a flexible tool, such as a legislative guide or a model law according to the topics, would contribute to harmonizing efforts in this sector and provide momentum for reforms which would further encourage micro-business participation in the economy.

11. At its forty-sixth session (2013), the Commission also heard a proposal from the Government of Colombia[10] suggesting that the Commission could create a mandate for a new Working Group focused on the life cycle of a business, particularly in relation to micro and small-sized enterprises. It was suggested that the Working Group could begin with the facilitation of simplified business incorporation and registration, following which it could continue with other matters, such as those discussed at the 2013 colloquium, in order to create an enabling legal environment for this type of business activity.

12. The Commission agreed, at its forty-sixth session (2013), that work on reducing the legal obstacles faced by micro, small and medium-sized enterprises throughout their life cycle, in particular, in developing economies, should be added to the work programme of the Commission, and that such work should begin with a focus on the legal questions surrounding the simplification of incorporation.[11]

13. At its twenty-second session (New York, 10-14 February 2014), Working Group I (MSMEs) commenced its work according to the mandate received from the

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[8] See A/CN.9/780, presentations made at the colloquium are available at www.uncitral.org/uncitral/en/commission/colloquia/microfinance-2013-papers.html.

[9] See A/CN.9/780, paras. 49-55.

[10] See A/CN.9/790.

[11] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 321.

Commission as noted in paragraph 12 above. Based upon the issues raised in working paper A/CN.9/WG.I/WP.82, the Working Group engaged in preliminary discussion in respect of a number of broad issues relating to the development of a legal text on simplified incorporation.[12] Business registration was also said to be of particular relevance in the future deliberations of the Working Group.[13] In order to make further progress, the Working Group requested the Secretariat to prepare a document setting out best practices in respect of business registration, as well as a template on simplified incorporation and registration to provide the basis for drafting a possible model law, without discarding the possibility of the Working Group drafting different legal instruments, particularly, but not exclusively, as they applied to MSMEs in developing countries.[14] In addition, a document was to be prepared by States outlining their experience in respect of alternative approaches to the challenges of simplified incorporation and supporting MSMEs.[15]

14. At its forty-seventh session, in 2014, the Commission reaffirmed the mandate of the Working Group, relative to reducing the legal obstacles faced by MSMEs throughout their life cycle, in particular those in developing economies, beginning with a focus on the legal questions surrounding the simplification of incorporation,[16] as agreed at the forty-sixth session of the Commission, in 2013.[17]

15. At its twenty-third session (Vienna, 17-21 November 2014), Working Group I continued its work according to the mandate received from the Commission. Following a discussion of the issues raised in working paper A/CN.9/WG.I/WP.85 in respect of best practices in business registration, and presentations by the Corporate Registers Forum, the European Business Register and the European Commerce Register's Forum,[18] the Working Group agreed to continue its work on business registration by further exploring the relevant key principles.[19] To that end, the Working Group requested the Secretariat to prepare further materials based on parts IV and V of working paper A/CN.9/WG.I/WP.85 for discussion at a future session. In its discussion of the legal questions surrounding the simplification of incorporation, the Working Group heard a presentation by the secretariat of the Financial Action Task Force (FATF) on its standard-setting activity to combat money-laundering, terrorist financing and other illicit activity,[20] as well as presentations by States of the information in working paper A/CN.9/WG.I/WP.87 on possible alternative legislative models to assist MSMEs.[21] The Working Group then proceeded to explore the legal questions surrounding the simplification of incorporation by considering the issues outlined in the framework set out in working

[12] See A/CN.9/800, paras. 34-38 and 42-46.
[13] See A/CN.9/800, paras. 47-50.
[14] See A/CN.9/800, para. 65.
[15] See A/CN.9/800, para. 65, and para. 15 below.
[16] *Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17* (A/69/17), para. 134.
[17] Ibid., *Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 321.
[18] See A/CN.9/825, paras. 12-38.
[19] Ibid., paras. 39-46.
[20] Ibid., paras. 47-55.
[21] Ibid., paras. 56-61.

paper A/CN.9/WG.I/WP.86,[22] and agreed that it would resume its deliberations at its twenty-fourth session beginning with paragraph 34 of A/CN.9/WG.I/WP.86.

2. Documentation for the twenty-fourth session

16. The Working Group will have before it, and may wish to use as a basis for its consideration, notes by the Secretariat regarding: (a) legal questions surrounding the simplification of incorporation (A/CN.9/WG.I/WP.86); and (b) a draft model law on a simplified business entity (A/CN.9/WG.I/WP.89), as well as such other documents that may be officially submitted by States.

17. In planning the attendance of their representatives, States and interested organizations may also wish to consider the following background documents:

(a) Report of Working Group I (MSMEs) on the work of its twenty-second and twenty-third sessions (A/CN.9/800 and A/CN.9/825);

(b) Notes of the Secretariat on selected activities of international and intergovernmental organizations to promote MSMEs (A/CN.9/WG.I/WP.81) and on features of simplified business incorporation regimes in selected States (A/CN.9/WG.I/WP.82);

(c) Observations by the Government of Colombia concerning the Colombian Simplified Corporation (A/CN.9/WG.I/WP.83);

(d) Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17 (A/69/17), paras. 131-134; and

(e) Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17 (A/68/17), paras. 316-322.

18. UNCITRAL documents are posted on the UNCITRAL website (www.uncitral.org) upon their issuance in all the official languages of the United Nations. Delegates may wish to check the availability of the documents by accessing the Working Group's page in the "Working Groups" section of the UNCITRAL website.

Item 6. Adoption of the report

19. The Working Group may wish to adopt, at the close of its session, a report for submission to the forty-eighth session of the Commission, scheduled to be held in Vienna, from 29 June to 16 July 2015. The main conclusions reached by the Working Group at its ninth meeting (on Friday morning) will be summarily read out for the record at the tenth meeting and subsequently incorporated into the report.

IV. Scheduling of meetings

20. The Working Group's twenty-fourth session will span five working days. There will be ten half-day meetings available for consideration of the agenda items. The Working Group may wish to note that, consistent with decisions made by the

[22] Ibid., paras. 62-79.

Commission at its thirty-fourth session,[23] the Working Group is expected to hold substantive deliberations during the first nine half-day meetings (that is, from Monday to Friday morning), with a draft report on the entire period being prepared by the Secretariat for adoption at the tenth and last meeting of the Working Group (on Friday afternoon).

21. The Working Group may wish to note that its twenty-fifth session will be held in Vienna and is tentatively scheduled from 19 to 23 October 2015.

[23] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and *Corrigendum* (A/56/17 and Corr.3), para. 381.

United Nations A/CN.9/WG.I/WP.89

General Assembly

Distr.: Limited
28 January 2015

Original: English

United Nations Commission on International Trade Law
Working Group I (MSMEs)
Twenty-fourth session
New York, 13-17 April 2015

Micro, small and medium-sized enterprises

Draft model law on a simplified business entity

Note by the Secretariat

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I. Introduction

1. At the conclusion of its twenty-third session (Vienna, 17 to 21 November, 2014), the Working Group agreed to continue at its twenty-fourth session consideration of the non-exhaustive framework of issues surrounding the simplification of the legal structure for micro, small and medium-sized enterprises (MSMEs) set out in Part V of working paper A/CN.9/WG.I/WP.86.[1] The following draft model law on a simplified business entity[2] (MLSBE) and commentary are intended to assist the Working Group in its further discussion of document A/CN.9/WG.I/WP.86 by presenting an illustration of how the principles being discussed could appear in a text, pending consideration by the Working Group of the remaining issues in A/CN.9/WG.I/WP.86 as well as a decision on what form the legal text should take. The draft MLSBE that follows incorporates the decisions made by the Working Group as of the end of its twenty-third session.

2. The Working Group may wish to note that the draft MLSBE combines the key principles applicable in an international context as drawn from the model act on simplified corporation contained in the annex to A/CN.9/WG.I/WP.83 ("Observations by the Government of Colombia") with experience found in legislative and reform activity in other parts of the world. The draft MLSBE addresses key considerations[3] for simplified business entities and their registration, including: (i) permitting participation by one or more persons;[4] (ii) providing for full-fledged limited liability; (iii) establishing simple registration and formation requirements; (iv) enabling maximum freedom of contract for participants while establishing clear default rules for less sophisticated entrepreneurs; (v) providing for a flexible organizational structure; (vi) making minimum capital an optional requirement; (vii) making a statement of an entity's purpose optional; (viii) allowing the use of intermediaries to be optional; (ix) providing for fiscal transparency and simplified accounting; and (x) building on the presumption that a ready-made business form statute should focus on the needs of the smallest entities first (the "think-small-first" principle). In addition, the draft MLSBE strives to create a stand-alone regime that encompasses all sizes of business entities, from the single member micro-business through to medium-sized enterprises.

3. The vast majority of enterprises in both the developing and the developed world are MSMEs. As recognized by the Commission through its decision to grant Working Group I its current mandate, in light of the forces of globalization and economic integration it is important to strengthen the economic role and position of MSMEs. The problem to be resolved is to establish what the best practices of governments and policymakers should be to create a legal structure so that these enterprises can thrive. When it comes to the organization of these entities, two distinct approaches can be identified. First, many States[5] have modernized and

[1] The Working Group agreed at the conclusion of its twenty-third session to resume its consideration of working paper A/CN.9/WG.I/WP.86 from paragraph 34 (para. 79, A/CN.9/825).

[2] The Working Group agreed at its twenty-third session to use the term "simplified business entity" or "simplified company" (para. 68, A/CN.9/825).

[3] See the list of key considerations outlined by some delegations as set out in para. 66 of the Report of the twenty-third session of the Working Group (A/CN.9/825).

[4] As agreed by the Working Group at its twenty-third session (para. 67, A/CN.9/825).

[5] For current details, information may be obtained at, inter alia, www.doingbusiness.org/reforms.

simplified the laws that govern business entities. Second, initiatives have been launched under which smaller enterprises receive certain incentives, including registration exemptions and tax benefits.

4. In this context, the following questions may be relevant: (1) would micro, small and medium-sized enterprises benefit from being permitted to select a redesigned, but already existing business form; (2) would newly introduced legal forms be better positioned to offer ready-made structures in which smaller enterprises could easily be started and nurtured into bigger ones; and (3) how many types of legal forms should be made available? Uniform answers to these questions are difficult, since the list of available legal business forms for privately held entities of all sizes differs from State to State.

5. In order to meet these challenges, a model law on a simplified legal business form should ideally offer enacting States the choice to adopt the model as a unified statute, which would achieve the greatest level of harmonization, which would in turn have a positive impact in terms of enabling MSMEs to trade internationally. However, since many States or regional organizations may have already enacted business forms for smaller enterprises, or may be in the process of doing so, such States could also use the draft MLSBE to improve their current regimes by choosing to implement one or more provisions or policies contained in the text to amend their statutes or legislative drafts. Using the term "simplified business entity", as agreed by the Working Group, captures a range of possible enterprises and is intended to reflect the flexibility and options open to States in implementing the attached draft MLSBE.

6. Pending discussion of this issue in the Working Group, the draft MLSBE currently takes a corporate approach, but it may be possible that a very simple, flexible business form such as the limited liability company could be a better starting point for businesses that are micro and small-sized enterprises. Such an approach would avoid the seemingly heavier corporate-type structures (e.g. references to shareholders, shares, boards of management, etc.) that are currently in the draft MLSBE, but that could be adapted in accordance with any decision by the Working Group in this regard.

7. It should also be noted that while there was agreement that the final legal text should include definitions, the Working Group also acknowledged that it would not be possible to consider specific terms for definition prior to finalization of the text.[6] As such, the current text of the draft MLSBE does not yet contain definitions. Similarly, the draft model law does not yet contain any standard form documents[7] (for example, a standard form operating document); such forms would also be prepared at a later date, once the Working Group has considered whether or not it wishes to further develop the draft MLSBE.[8]

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[6] See para. 68, A/CN.9/825.

[7] The Working Group has previously noted that while freedom of contract should be the guiding principle in terms of establishing the internal organization of a company, micro and small businesses could find this freedom a challenge. As such, it was suggested that the preparation of certain standard form documents could be useful for micro and small businesses (see para. 63, A/CN.9/800).

[8] See, also para. 47 below.

II. Text of a draft model law on a simplified business entity[9]

Chapter I — General provisions

Article 1. Nature

A simplified business entity may be organized under this law for any lawful commercial activity, including the ownership of property, subject to any law of [insert the enacting State] governing or regulating such activities.

8. *Comment* — A simplified business entity may be organized for any lawful commercial[10] purpose unless the enacting State has specifically prohibited a simplified business entity from engaging in a specific activity or certain regulated industries, such as the banking or insurance industry.[11] If an enacting State wishes to prohibit or exclude certain activities of a simplified business entity, or if it wishes to broaden its permitted activities to those that are not strictly commercial, it could be accomplished by making adjustments to this provision.

9. The Working Group agreed at its twenty-third session that the purpose clause, if any, of the simplified business entity should be broad so as to provide maximum flexibility for the enterprise. In addition, it was noted that in multiple jurisdictions, a layer of regulatory, licensing, permit and inspection regimes prescribed and regulated the business activities of MSMEs in the same way as the specific purpose clause in the operating document.[12]

Article 2. Legal personality

A simplified business entity is an entity distinct from its shareholders. A simplified business entity has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities.

10. *Comment* — The draft MLSBE embraces the legal personality approach in order to give a clear expression to the nature of the business form as a legal entity separate from its shareholders. The status of a simplified business entity for tax purposes should not affect its status as a separate legal entity formed under this model law. It should be noted that there was a suggestion made in the Working Group at its twenty-third session that the term "legal personality" could be susceptible to different meanings in different States and in varying contexts, and that it might be preferable to avoid use of the term and simply define its principles in the text.[13] This could easily be accomplished by deleting the title "Article 2. Legal personality" and moving the content of article 2, which sets out the

[9] Supra, note 2.

[10] The Working Group decided to limit the simplified business entity to a commercial privately held entity (see para. 69, A/CN.9/825).

[11] The Working Group confirmed its view that it was not necessary to approach the issue of simplified business entities with a specific entity size in mind, but agreed that it might be useful to establish what the scope of application of the legal text would be, for example, that it might exclude enterprises in certain highly regulated sectors (see para. 68, A/CN.9/825).

[12] See para. 70 of A/CN.9/825.

[13] See para. 72 of A/CN.9/825.

principles of the concept of legal personality, to become paragraph 2 of article 1 on "Nature".

11. The draft MLSBE takes the view that separation of the assets of the simplified business entity from the personal assets of the shareholders of a simplified business entity is viewed as the defining characteristic of the legal personality status. However, it should be noted that there are also legislative models that permit the separation of business assets of the entity from the personal assets of its members without resort to legal personality, such as those described in working paper A/CN.9/WG.I/WP.87 and presented to the Working Group at its twenty-third session.[14] A description of such regimes could be included in the text adopted by the Working Group, perhaps in an explanatory section.

Article 3. Limited liability[15]

> Except as provided by the operating document, a shareholder is not solely by reason of being a shareholder liable to any person, including another shareholder, directly or indirectly, by contribution, indemnity or otherwise, for any obligation of the simplified business entity.

12. *Comment* — The term "operating document" is used throughout the draft MLSBE and refers to the document or electronic record that governs the affairs of a simplified business entity, including articles of association, by-laws or other operating documents. The operating document should not have to be filed or disclosed; this is in order to protect privacy and to avoid the need to file amendments with the authorities should it be necessary or desirable to change the entity's operating document. As stated in article 6 of this draft model law, a simplified business entity is formed by executing and filing a "formation document" which requires the disclosure of only a few facts, including the name of the simplified business entity.

13. In order to offer a clear and simple framework to economic actors, the simplified business entity offers limited liability protection to its shareholders. The presence of a liability shield generally prevents the shareholders of a simplified business entity from incurring personal liability as a result of the activities of the simplified business entity in the ordinary course of the business.

14. There is a wide range of academic literature that argues that the presence of limited liability may introduce the prospect of opportunistic behaviour, i.e., attempts by shareholders to shift the risk of business failure to third parties or outsiders. Some have suggested that limited liability should not be considered as an essential feature of business entities. Others are of the view that the uncertainty surrounding the efficiency of limited liability lends support to introducing special rules and regulations, such as minimum capital and capital maintenance requirements, to protect voluntary and involuntary creditors (such as tort creditors) of the firm. However, the reliance on minimum capital requirements to balance the levels of risk-taking may be deceptive. By their very nature, these requirements may impede

[14] See paras. 56-61, A/CN.9/825.

[15] There was broad agreement by the Working Group at its twenty-third session that the entity should enjoy limited liability (see para. 69, A/CN.9/825).

innovation, business entry and investment, and consequently create unnecessary barriers to trade and social welfare.

15. While there was no consensus reached by the Working Group at its twenty-third session on the issue of whether or not minimum capital requirements should be required to offset the limited liability of an enterprise, there was broad agreement that the modern trend in legal reform in this area was to move away from minimum capital requirements.[16] Moreover, there was general approval by the Working Group of the list of other possible mechanisms to protect creditors and third parties set out in paragraph 32 of working paper A/CN.9/WG.I/WP.86.[17]

16. In keeping with the modern trend, the draft MLSBE does not contain a minimum capital requirement for the establishment of a simplified business entity. In order to provide some protection to creditors, it includes the principle that members of the board of management may incur a liability for improper distributions and an obligation for shareholders to repay improper distributions to the simplified business entity (article 9). The draft model law is sufficiently flexible for enacting States to include a minimum capital requirement, or a progressive capital requirement, but it is recommended that in order to foster the establishment and success of MSMEs, any such capital requirements should be restricted to a nominal sum.

Article 4. Name of entity

1. The name of the simplified business entity must contain the phrase [*specify the relevant phrase for the entity in the enacting State*] or the abbreviation [*specify the relevant abbreviation for the entity in the enacting State*].

2. The name of the simplified business entity must be distinguishable upon the records of the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*] from the name of any other registered legal entity in [*insert the enacting State*], unless the use of the name is authorized by the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

17. *Comment* — The enacting State should choose a phrase or suffix and abbreviation that would enable the simplified business entity to be distinguished

[16] See paras. 75-78 of A/CN.9/825.

[17] The other mechanisms for third party protection listed were: (a) the liability of members of the business entity for improper distributions and the obligation to repay the entity for any improper distributions; (b) standards of conduct including good faith and fiduciary responsibilities; (c) limited liability to be lifted in certain circumstances ("piercing the corporate veil"); (d) transparency in accounting and auditing of financial statements; (e) the establishment of credit bureaus; (f) a supervisory role to be established for commercial registries or specialized agencies; and (g) corporate governance oversight. The Working Group agreed that this list could be expanded, and additional possible mechanisms suggested were: (a) requirements in respect of the transparency, quality and public availability of registered information on the business entity and its managers; (b) requirements that the entity's business name not be misleading and that its name be set out in contracts, invoices and other dealings with third parties; and (c) that the founders and managers of an entity could not be bankrupt and that they be required to be of legal age and sound mind (see paras. 77-78, A/CN.9/825).

from other business entities in the State, provided that the phrase or abbreviation indicates that the enterprise is a simplified business entity that enjoys limited liability.[18] In addition, certain States provide for the registration (and approval) of company names to enable the appropriate commercial registry or other body administering business associations under the law of the enacting State to prevent the proposed name of the simplified business entity from conflicting with the name of another entity or any trade names.

18. Enacting States may include an article stating that a person may reserve the exclusive use of a name by delivering an application to the appropriate commercial registry or other body administering business associations under the law of the enacting State.

19. The provision in paragraph 2 allowing authorities to authorize the use of a name similar to or indistinguishable from that of another business entity is best understood in the context of micro and small businesses, where two entities could possess similar names but be engaged in very different industries and/or distant geographical areas, and thus be quite distinguishable in fact.

Chapter II — Formation and proof of existence

Article 5. Formation of a simplified business entity

1. One or more natural or legal person(s) may form a simplified business entity consisting of one or more shareholder(s) by executing a formation document and delivering it to the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

2. Unless a future effective date not more than 90 days after the delivery of the formation document is specified in the formation document, the existence of the simplified business entity begins when the formation document is executed and delivered to [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

3. A simplified business entity is formed at the time of execution and delivery of the formation document or at a future date specified in the formation document but not more than 90 days after the delivery of the formation document, if there has been compliance with the requirements of article 6.

20. *Comment* — The Working Group agreed at its twenty-third session that the instrument being prepared should, in a single text, accommodate the creation of a simplified business entity by one or more persons, and that it should accommodate the evolution of a business entity from a very small one to a more complex multi-member entity.[19] Thus, the draft MLSBE accommodates the formation of a simplified business entity by one or more natural or legal persons. In some enacting States, formation is coupled with a review of the formal correctness of the formation

[18] The Working Group agreed on this approach at its twenty-third session (see para. 69, A/CN.9/825).

[19] See paras. 67 and 74 of A/CN.9/825.

document by a court, administrative agency or notary, and in such cases, paragraphs 1 and 2 should be adjusted accordingly.

21. Ideally, delivery of the formation document may also be accomplished electronically, provided that the information can be retrieved in printed form or in a manner so as to be usable for subsequent reference. If a future effective date not more than 90 days after delivery of the formation document is specified, it is on that date that the existence of the simplified business entity begins. The electronic filing of formation documents enables legal entities to be created without the intervention of intermediaries, and it might be argued that this trend could increase the potential for misuse of the legal entity (e.g. for money-laundering or terrorist financing; see also A/CN.9/WG.I/WP.82, paras. 26 to 32 and A/CN.9/825, paras. 47 to 55). However, it should be recalled that business entities, in order to conduct activities, often must open bank accounts that require the submission of taxation and other identification numbers, and financial institutions may remain the most suitable parties to prevent and combat money-laundering and other illicit activities. In addition, States should be aware of the international standards applicable to these issues, such as those referred to below in paragraph 26.

Article 6. Formation document

1. The formation document must set forth:

(a) The name of the simplified business entity;

(b) The street address, if any, mailing address and domicile of the simplified business entity;

(c) The name and mailing or service address of each member of the board of management; and

(d) The date on which the simplified business entity is to dissolve, if the simplified business entity is to have a specific date of dissolution.

2. The formation document may also set forth:

(a) Any provision for the management of the simplified business entity and for the conduct of the affairs of the simplified business entity, and any provision creating, defining, limiting, or regulating the powers of the simplified business entity and its members of the board of management;

(b) Any provision regarding the capitalization of the simplified business entity, such as authorized classes of shares and a par value, if any, for the authorized classes of shares; and

(c) Any other matters relating to the simplified business entity that the persons forming the simplified business entity determine to include therein.

3. The formation document must be amended if the information required in paragraph 1 changes, and may be amended at any time for any purpose by unanimous consent of the shareholders or as may be provided in the operating document, by executing and delivering an amendment to [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

22. *Comment* — In certain enacting States, companies are required to disclose the nominal value, class of the shares and the extent to which the shares are paid up in the formation document. In enacting States that have abolished the notion of par value, companies are required to disclose the amounts paid, amounts unpaid (if any) on the shares, the class of the shares and the extent to which the shares are paid up.

23. It is necessary to disclose the name and mailing address of each member of the board of management in order to enable the appropriate commercial registry or other body administering business associations under the law of the enacting State to adequately monitor and observe their work in respect of the maintenance of the entity's books and records.

24. The members of the board of management of a simplified business entity are required only to provide a mailing or service address rather than a residential address to be registered and available to the public. If an enacting State decides to implement the requirement to provide the appropriate commercial registry or other body administering business associations under the law of the enacting State with a residential address, the residential address should not appear on the public registry (and should only be available to predetermined organizations such as governmental and credit reference agencies). The rationale behind this is that members of the board of management may feel that the public availability of their residential address presents a risk to their safety.

25. If enacting States decide to require a company secretary (to ensure that there is a person in charge of company administration matters and compliance), the name and address of the company secretary (instead of each of the members of the board of management) must be included in the formation document.

26. In addition, Financial Action Task Force (FATF) Recommendation 24[20] in respect of transparency and beneficial ownership of legal persons encourages States to conduct comprehensive risk assessments of legal persons and to ensure that all companies are registered in a publicly available company registry. The basic information required is: (a) the company name; (b) proof of incorporation; (c) legal form and status; (d) the address of the registered office; (e) its basic regulating powers; and (f) a list of directors. In addition, companies are required to keep a record of their shareholders or members.

Chapter III — Shares and capital

Article 7. Shares

1. A simplified business entity may issue one or more classes of shares, any or all of which classes may be of shares with par value or shares without par value and which classes may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions

[20] International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations, Part E on Transparency and Beneficial Ownership of Legal Persons and Arrangements, Recommendation 24 (www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf). See, also, paras. 47-55 of A/CN.9/825.

thereof, as shall be stated and expressed in the operating document or any amendment thereto.

2. Any share of any class may be made convertible into or exchangeable for shares of any other class as provided for in the operating document.

Article 8. Special rights

Any special rights granted to the holders of any class of shares shall be described or fixed upon the face or back of each share certificate issued to represent any such shares, or, where no share certificates are issued, in the operating document of the simplified business entity.

Article 9. Distributions

1. Shareholders are entitled to receive distributions if declared by the board of management or shareholders or any other person or persons as provided in the operating document. The order of the distribution of dividends depends on the class of shares held by the shareholder.

2. The board of management of every simplified business entity or shareholders or any other person or persons as provided in the operating document, subject to any restrictions contained in its operating document and the limitation in paragraph 3, may declare and pay dividends upon the shares.

3. No distribution may be made if, after giving it effect: (a) the simplified business entity would not be able to pay its debts as they become due in the usual course of business; or (b) the simplified business entity's total assets would be less than the sum of its total liabilities plus (unless the operating document permits otherwise) the amount that would be needed, if the simplified business entity were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

4. Distributions may be paid in cash or in property of the simplified business entity.

Article 10. Redemption

Any shares of any class are subject to redemption by the simplified business entity at its option or at the option of the shareholders, subject to any restrictions contained in the operating document and the limitation in article 9, paragraph 3, provided however that the simplified business entity shall have outstanding one or more shares.

Article 11. Liability for improper distributions

A shareholder who receives a distribution in violation of article 9, paragraph 3, and who knew or ought reasonably to have known at the time of the distribution that the distribution violated article 9, paragraph 3, shall be liable to the simplified business entity for the amount of the distribution.

Article 12. Consideration for shares

1. Subject to any limitations and restrictions set forth in the operating document, a simplified business entity may issue shares without par value for such consideration as may be prescribed in the operating document, or, if not prescribed, then for such consideration as may be fixed by resolution passed by the shareholders of the simplified business entity at any annual meeting thereof, or at any special meeting thereof duly called for that purpose, or by the board of management acting under authority of such shareholders given in like manner.

2. The board of management or shareholders may authorize shares to be issued for tangible or intangible property or other benefit to a simplified business entity, including money, services performed, promissory notes, other binding agreements to contribute money or property, and contracts for services to be performed.

3. Any simplified business entity may, by resolution of its board of management, determine that only part of the consideration received by the simplified business entity for any shares having a par value must be recorded as share capital. The consideration which will be received by the simplified business entity for any of the shares exceeding the par value will be recorded as share premium/surplus.

4. The power to issue new shares may be reserved to the shareholders by the operating document or by any special resolution by the shareholders.

5. A shareholder's obligation to make a contribution to a simplified business entity is not excused by the shareholder's death, disability, or other inability to perform personally. If a shareholder does not make a contribution required by an enforceable promise, the member or the member's estate is obligated, at the election of the simplified business entity, to contribute money equal to the value of the portion of the contribution that has not been made. The foregoing election shall be in addition to, and not in lieu of, any other rights, including the right to specific performance, that the simplified business entity may have under the operating document or applicable law.

Article 13. Partly paid shares

Any simplified business entity may, by resolution of its board of management, issue the whole or any part of its shares as partly paid and subject to call for the remainder of the consideration to be paid therefor.

27. *Comment* — As mentioned in the comment under article 3, it has been observed that minimum capital and capital maintenance regimes may be largely ineffective and may create obstacles for economic actors starting a business. Against this background, enacting States may consider including rules in the area of distributions (e.g. dividends or share buybacks) which assign responsibility to the board of management, and liability rules for members of the board of management for reviewing the distributions. Also, enacting States may wish to consider certain variations to the liability rules, such as a statutory obligation for shareholders to return any distribution that was made to them within one year prior to bankruptcy.

28. Paragraph 9(3) of the draft MLSBE contains an "insolvency test" in combination with a "balance sheet test". Under the insolvency test, the simplified business entity must be able to pay its debts after giving effect to the distribution. The balance sheet test ensures that distributions are only made if the simplified business entity's total assets exceed its total liabilities.

29. Improper distributions or improper share purchase or redemption could result in or lead to the members of the board of management or shareholders becoming jointly and severally liable if a certain minimum capital requirement or requirements regarding the insolvency equity test or balance sheet test are not respected.

Chapter IV — Share transfers

Article 14. Restrictions on share transfer

The operating document may impose restrictions on the transfer of shares of the simplified business entity, including shareholder approval for the transfer of shares or options or rights of first refusal by the existing shareholders.

Article 15. Breach of restrictions on share transfer

Any transfer of shares carried out in a manner inconsistent with the rules set forth in the operating document shall be null and void.

Article 16. Shareholders' pre-emptive rights

The shareholders of a simplified business entity do not have a pre-emptive right to acquire the simplified business entity's unissued shares, except to the extent the operating document so provides.

30. *Comment* — In micro, small and medium-sized enterprises, share transfer restrictions typically constitute contractual obligations to offer or sell shares either to the other shareholders or to the business entity before offering or selling them to third parties. As long as the restriction is limited to rights of first refusal or straightforward buy-sell agreements, it is not necessary to limit the duration of the share transfer restrictions. A better (and generally accepted) test as to the share transfer restrictions may be that it must not unreasonably restrain or prohibit transferability.

Chapter V — Shareholders' meetings

Article 17. Meetings

Meetings of shareholders must take place at least once per year and may be held at any place designated by the shareholders, whether or not it is the domicile of the simplified business entity.

Article 18. Conduct of the shareholders' meeting

1. At each shareholders' meeting, a chair must preside. The chair must be appointed as provided in the operating document or, in absence of such provision, by the shareholders.

2. The operating document or the shareholders may assign to one of the members of the board of management or one of the shareholders or any other person responsibility for preparing minutes of the shareholders' meeting.

Article 19. Meetings by technological means or by written consent

Meetings of shareholders may be held through any available technological means, or by written consent. The minutes of such meetings shall be included in the simplified business entity books and records no later than thirty days after the meeting has taken place. These minutes shall be signed by the person responsible for preparing the minutes of the shareholders' meeting pursuant to article 18, paragraph 2.

Article 20. Notice of meeting

1. The board of management or the person or persons authorized to do so by the operating document shall convene the shareholders' meeting by written notice addressed to each shareholder or by facsimile, telecommunication, by electronic mail, by posting on an electronic network or any other form of electronic transmission when directed to and consented to by the shareholders. Such notice must be [made] [provided] [received] at least five days in advance of the meeting, unless a different time period is specified in the operating document.

2. The notice must include the agenda of the meeting as well as the place, if any, date and hour of the meeting, and the means of remote communication, if any, by which shareholders may be deemed to be present in person and voting at such meeting.

3. Notwithstanding the content of the notice and agenda, the members of the board of management or member of any other body of the simplified business entity must provide to the shareholders all the information requested by a shareholder, if the request for information is made in good faith and with a proper purpose.

Article 21. Waiver of notice

Whenever notice is required to be given under any provision of this law or the operating document, a written waiver, signed by the shareholder entitled to notice, or a waiver by electronic transmission by the shareholder entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a shareholder at a meeting shall constitute a waiver of notice of such meeting, except when the person attends the meeting and makes an objection at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened.

Article 22. Quorum and majorities

1. Unless otherwise specified in the operating document, the quorum at a shareholders' meeting will consist of a [majority] [1/3] [1/5] [...] of the shares entitled to vote, whether present in person or represented by proxy.

2. Decisions of the shareholders' meeting shall be taken by an affirmative vote of the majority of shares present in person or represented by proxy, unless the vote of a greater number is required by this law or in the operating document.

3. The sole shareholder of a simplified business entity may adopt any and all decisions within the powers granted to the shareholders' meeting. The sole shareholder shall keep a record of such decisions in the company books and records.

4. Any notice of meeting may determine the date on which the second call meeting will take place, in the event that the quorum is insufficient to hold the first meeting. The date for the second meeting may not be held earlier than ten days, nor later than thirty days, following the date of the first meeting.

Article 23. Cumulative voting

The operating document of any simplified business entity may provide that at all elections of members of the board of management or members of any other body of the simplified business entity, or at elections held under specified circumstances, each shareholder shall be entitled to as many votes as shall equal the number of votes which (except for such provision as to cumulative voting) such shareholder would be entitled to cast for the election of members of the board of management or members of any other entity body with respect to such shareholder's shares multiplied by the number of members of the board of management or members of any other entity body to be elected by such shareholder, and that such shareholder may cast all of such votes for a single member of the board of management or member of any other entity body or may distribute them among the number to be voted for, or for any 2 or more of them as such shareholder may see fit.

31. *Comment* — Shareholders in simplified business entities often view themselves as partners with equal financial and managerial control rights. This may be true in the context of strong relational ties based on trust, but once dissatisfaction or distrust disrupts the relationship, the shareholders may be unable to negotiate their way out of the dispute. In simplified business entities, the deadlock problem is often avoided by the principle of majority rule, which may result in minority oppression. Minority shareholders may face an indefinite future when there is, for instance, a conflict between the controlling shareholder and the minority shareholders. In the event that all the shareholders work in the business, the controlling shareholder may dismiss the minority, who then can either keep their shares, which pay no dividend, or sell them back to the firm for whatever price the controlling shareholder is willing to offer.

32. In such an oppressive situation, minority shareholders are not necessarily deprived of participation in any decision-making process. Shareholders are usually entitled to attend shareholders' meetings where they are able to participate in discussions and vote on agenda items. In most jurisdictions, shareholders are also allowed to convene a meeting when they hold at least a defined percentage (usually 10 per cent) of the issued share capital. However, in non-listed companies, which are characterized by "the decision-making by majority" principle, controlling shareholders dominate the election of members of the board of management and

influence directly the fundamental decisions, establish company policy, perform the main monitoring functions, and sometimes act as the firm's agents. In such circumstances, minority shareholders may be particularly vulnerable to opportunistic acts by the controlling shareholders. Indeed, the majority shareholder has a range of strategies at its disposal to extract resources from firms they control. These include: (1) distributions of cash and property to confer benefits on shareholders; (2) dilutive share issues; (3) interested transactions; (4) allocation of corporate opportunities; (5) allocation of business activities; and (6) selective disclosure of non-public information.

33. Simplified business entities may allow provisions in the operating document which provide minority shareholders with a right to veto important resolutions. In this respect, three arrangements may be distinguished. First, operating documents may require unanimity or a "supermajority" vote for particular shareholder actions, such as the alteration of the operating document and restructuring activities. Second, the draft MLSBE allows for dual-class share arrangements which give some shares more votes than other shares on particular issues, such as the appointment of members of the board of management, or on all issues.

34. Lastly, the operating document may fix high quorum requirements for shareholders' meetings. A high quorum requirement in conjunction with a high supermajority vote requirement may even create double protection for minority shareholders. These devices could, however, create incentives for the minority to behave opportunistically toward the majority, thereby extracting disproportionate concessions.

35. The safest way to ensure that the interests of minority shareholders are represented on the board of management is the use of different classes of shares that have identical financial rights but are entitled to vote separately as classes for the election of specified numbers of board members (see, for example, article 24, paragraph 4 of the draft MLSBE). Another option is cumulative voting: a voting system found in a number of jurisdictions that gives minority shareholders more power, by allowing them to cast all of their "board of management" votes for a single candidate. Cumulative voting, however, may easily be eliminated or minimized by the controlling shareholder. For instance, a controlling shareholder can simply alter the articles of association or remove the minority shareholders' member of the board of management without cause and replace him or her with a more congenial person. In addition, controlling shareholders may be reluctant to adopt cumulative voting. Despite these shortcomings, however, the draft MLSBE permits the operating document of the simplified business entity to include cumulative voting provisions.

Chapter VI — Organization of the simplified business entity

Article 24. Management of the simplified business entity

1. The business and affairs of every simplified business entity organized under this law shall be managed by or under the direction of a board of management, except as may be otherwise provided in the operating document. If any such provision is made in the operating document, the powers and duties imposed on the board of management by this chapter may also be

exercised and performed by the shareholders or any other person or persons as provided in the operating document.

2. If there is a board of management, it must consist of one or more legal or natural persons. The number of members of the board of management, if any, shall be fixed by or in the manner provided in the operating document, unless the formation document stipulates the number of members of the board of management, in which case a change in the number of members of the board of management may only be made through amendment of the formation document or as provided in the formation document.

3. Members of the board of management need not be shareholders unless so required by the formation document or the operating document. The formation document or operating document may prescribe other qualifications for members of the board of management. Each member of the board of management shall hold office until such member's successor is elected and qualified or until such member's earlier resignation or removal.

4. Members of the board of management are elected at the first shareholders' meeting and each annual meeting thereafter unless otherwise provided in the operating document. If the operating document authorizes dividing the shares into classes, the operating document may also specify the election of all or a specified number of members of the board of management by the holders of one or more classes of shares. A class (or classes) of shares entitled to elect one or more members of the board of management is a separate voting group for the purposes of the election of members of the board of management.

5. Any member of the board of management or the entire board of management may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of members of the board of management or by any other procedure established in the operating document, unless the formation document otherwise provides.

6. A member or members of the board of management, if any, must comply with the rules of procedure in the operating agreement, and must act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the interests of the simplified business entity and its shareholders.

7. The board of management may hold regular or special meetings. Unless the operating document provides otherwise, the board of management may permit any or all members of the board of management to participate in a regular or special meeting by, or conduct the meeting through the use of, any means of communication by which all members of the board of management participating may simultaneously hear each other during the meeting. A member of the board of management participating in a meeting by this means is deemed to be present in person at the meeting.

8. (a) Except to the extent that the operating document requires that action by the board of management be taken at a meeting, action required or permitted by this law to be taken by the board of management may be taken without a meeting if each member of the board of management signs a consent

describing the action to be taken and delivers it to the simplified business entity.

(b) Action taken under this article is the act of the board of management when one or more consents signed by all the members of the board of management are delivered to the simplified business entity. The consent may specify the time at which the action taken thereunder is to be effective. A member's consent may be withdrawn by a revocation signed by the member of the board of management and delivered to the simplified business entity prior to delivery to the simplified business entity of unrevoked written consents signed by all the members of the board of management.

Article 25. Relations with persons dealing with the simplified business entity

Relations with persons dealing with the simplified business entity must be conducted by one or more members of the board of management (if any) or other persons appointed in the manner provided in the operating document. The members of the board of management or persons authorized to represent a simplified business entity may undertake all actions in the ordinary course of business unless the formation document or operating document states otherwise.

Article 26. Supervision

1. In addition to a board of management, the operating document may provide for the inclusion of a supervisory board, which must consist of one or more natural persons. The operating agreement may also contain provisions regarding the appointment of one or more non-executive members of the board of management in the board of management. Non-executive members of the board of management can only be natural persons.

2. The duties of the non-executive members of the board of management or the members of the supervisory board shall be the supervision of the policy of the management and the general course of affairs of the simplified business entity and the enterprise connected therewith. It shall assist the executive members of the board of management with advice. In the performance of their duties, the non-executive members of the board of management or members of the supervisory board shall act in the interest of the simplified business entity.

3. The operating document may contain supplementary provisions regarding the duties and powers of the non-executive members of the board of management or the supervisory board and its members, including its rules and operations. Such supplementary provisions may also include the creation of one or more committees and the appointment of one or more members of the supervisory board to serve on any such committee.

36. *Comment* — As noted above, the simplified business entity is best viewed as a particular standard form contract which offers a clear solution for the problems that may occur in multi-owner closely held companies in which the identity of the shareholders is an important characteristic due to: (1) the relatively small number of shareholders; (2) there being no ready market for the sale and transfer of shares; and (3) the existence of substantial (majority) shareholder participation in the

management, direction and operation of the firm. The centralized management feature (which is common in listed companies) may be poorly tailored to fit the governance needs of closely held firms. When ownership and control are typically not completely severed, as is usually the case in these firms, the delegation of control rights is not as important or as precarious as in listed companies. Moreover, the majority rule, which gives control to holders of a majority of the outstanding voting shares, creates an opportunity to oppress minority shareholders by, among other things, appropriating corporate opportunities and distributing cash and property to majority shareholders.

37. From the standpoint of efficiency, business parties generally prefer to use a legal organizational form that defines and sets forth the ownership structure and provides certain governance options in advance. The draft MLSBE provides for a centralized management structure (i.e., the inclusion of a board of management) unless otherwise provided in the operating document. A simplified business entity without a formal board of management and with shareholders as the governing body is also permitted. The draft MLSBE also makes it possible to include a supervisory board in the governance structure of the simplified business entity. Aside from the so-called "two-tier system" in which a supervisory board not only has to give advice to the board of management, but is also furnished with monitoring activities, the operating document may opt into a one-tier board structure. A one-tier board consists of both executive and non-executive members of the board of management.

38. The draft MLSBE builds on the premise that freedom of contract should to a large extent govern the internal governance structure of the simplified business entity. The freedom of contract principle also applies to fiduciary duties. It is increasingly accepted that these duties should vary across business organizations. In fact, fiduciary duties have evolved differently across a range of contexts involving different types of parties and consensual relationships. The draft MLSBE does not specify or define any standards of duty or conduct for any person (shareholder or member of the board of management, the supervisory board or of any other body). These matters are determined by the operating document and other applicable law. However, it should be noted that the Working Group may wish to include fiduciary duties in the draft MLSBE, since a failure to do so could lead to the conclusion that there are no fiduciary duties in the context of the simplified business entity.

39. In light of the "think small first" paradigm, another approach could be to impose an open-ended and broad fiduciary duty on the shareholders of a simplified business entity. The focus on business relationships between relatives and long-standing acquaintances, in which trust plays a pivotal role, justifies the adoption of very broad fiduciary duties. The draft MLSBE could simply prescribe what parties actually believe and expect without being detrimental to the self-governing character of the business relationship. Because parties in these relationships usually have only a vague awareness of the governing rules, broad fiduciary duties are not expected to undermine trust among the business participants or entail over-monitoring. Certainly, in order to produce guidelines for the application of fiduciary duties, enacting States could define specific duties.

40. The draft MLSBE provides great contractual flexibility with respect to these matters by permitting the operating document to expand, restrict, or eliminate default fiduciary duties. It is, however, recommended that the operating document include the following provisions: (1) a duty to act in good faith and reasonably in

the best interests of the simplified business entity, (2) a duty to disclose information and (3) a duty to preclude from self-dealing transactions, personal use of assets of the simplified business entity, usurpation of opportunities of the simplified business entity, and competition with the simplified business entity.

Chapter VII — Restructuring

Article 27. Amendments to the operating document

Amendments to the operating document shall be approved by unanimous vote or in the manner provided in the operating document.

Article 28. Restructuring

1. The [*insert appropriate applicable law of enacting State*] governing conversion into another form, mergers and split-off proceedings for business associations will be applicable to the simplified business entity. Dissenters' rights and appraisal remedies shall also be applicable.

2. For the purpose of exercising dissenters' rights and appraisal remedies, a simplified business entity restructuring will be considered detrimental to the economic interests of a shareholder, inter alia, whenever:

(a) The dissenting shareholder's percentage in the subscribed paid-in capital of the simplified business entity has been reduced;

(b) The simplified business entity's equity value has been diminished; or

(c) The free transferability of shares has been unreasonably restricted.

Article 29. Conversion into another business form

1. Any existing business entity may be converted into a simplified business entity by unanimous decision rendered by the shareholders. Any such conversion must be registered with the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

2. A simplified business entity may be converted into any other business form governed under the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*] provided that a unanimous decision to that effect is rendered by the shareholders of all issued and outstanding shares in the simplified business entity.

Article 30. Substantial sale of assets

1. Whenever a simplified business entity purports to sell or convey assets and liabilities amounting to [60] [...] per cent or more of its equity value, unless a different amount is specified in the operating document, such sale or conveyance will be considered to be a substantial sale of assets.

2. Substantial sales of assets shall be approved by majority vote or in the manner provided in the operating document.

3. Whenever a substantial sale of assets is detrimental to the interests of one or more shareholders, it shall give rise to the application of dissenters' rights and appraisal remedies.

Article 31. Short-form merger

1. In any case in which at least [90] [...] per cent of the outstanding shares of a simplified business entity is owned by another legal entity, such entity may absorb the simplified business entity by the sole decision of the boards of management of all entities directly involved in the merger.

2. Short-form mergers may be executed by private document delivered to the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

41. *Comment* — The provisions above generally make reference to the appropriate applicable laws of the enacting States.

Chapter VIII — Dissolution and winding-up

Article 32. Dissolution and winding-up

1. The simplified business entity shall be dissolved and wound up whenever:

(a) An expiration date, term or event has been included in the formation document and such term has elapsed, provided that a determination to extend it has not been approved by the shareholders, before or after such expiration has taken place;

(b) Compulsory liquidation proceedings have been initiated;

(c) An event of dissolution set forth in the operating document has taken place;

(d) A majority shareholder decision has been rendered or such decision has been made by the will of the sole shareholder; or

(e) A decision to that effect has been rendered by any authority with jurisdiction over the simplified business entity.

2. Whenever an expiration term has elapsed, the simplified business entity shall be dissolved automatically. In all other cases, the decision to dissolve the simplified business entity must be delivered to the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

Article 33. Curing events of dissolution

Events of dissolution may be cured by adopting any measures available to that effect, provided that such measures are adopted within one year following the date on which the shareholders' meeting acknowledged the event of dissolution.

Article 34. Winding-up

The simplified business entity will be wound up in accordance with the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*]. The board of management shall act as liquidator, unless shareholders appoint any other person to wind up the business entity.

42. *Comment* — The winding-up section generally makes reference to the appropriate applicable laws of the enacting States.

Chapter IX — Miscellaneous

Article 35. Financial statements

1. The board of management shall submit financial statements and annual accounts to the shareholders' meeting for approval. In the absence of a board of management, the shareholders must consider financial statements and annual accounts for approval.

2. The financial statements and annual accounts must be included in the company books and records.

3. All financial statements referred to in this article shall meet the requirements of the accounting rules and other disclosure requirements of the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*].

43. *Comment* — While the focus of the draft MLSBE is on micro, small and medium-sized enterprises, disclosure and transparency are important issues facing any business entity. While some States apply broad disclosure requirements to closely held entities (but allow exceptions to be made for small and medium-sized firms), others restrict mandatory disclosure to publicly held firms.[21] In any event, minority shareholders of closely held entities are generally entitled to substantial information by using their right to inspect the company books and records.

Article 36. Shareholders' agreements

Agreements entered into among shareholders concerning the acquisition or sale of shares, pre-emptive rights or rights of first refusal, the exercise of voting rights, voting by proxy, or any other valid matter, shall be binding upon the simplified business entity, provided that such agreements have been filed with the simplified business entity. Shareholders' agreements shall be valid for any period of time determined in the relevant agreement.

[21] While micro, small and medium-sized companies are not required to provide the same flow and rate of information as publicly held firms generally, arguably they should have strong incentives for doing so. Indeed, the best run companies, which are more attractive to investors, signal their accountability by supplying information about: (1) the company's objectives; (2) principal changes; (3) balance sheet and off-balance sheet items; (4) financial position of the firm and its capital needs; (5) composition of the management board and company policy for appointments and remuneration; (6) forward-looking expectations; and (7) profits and dividends. However, such considerations are not likely to trouble the smaller enterprises contemplated under this draft model law.

Article 37. Shareholder exclusion

1. The operating document may contain causes by virtue of which shareholders may be excluded from the simplified business entity. Excluded shareholders shall be entitled to receive fair value for their shares of stock.

2. Shareholder exclusion shall require majority shareholder approval, unless a different procedure has been set out in the operating document.

Article 38. Conflict resolution

1. Any conflict of any nature whatsoever, excluding criminal matters, that arises among shareholders, members of the board of management or any other persons related to the simplified business entity or the simplified business entity may be submitted to arbitration proceedings or to any other alternative dispute resolution procedure.

2. The decisions rendered by the tribunal are final and shall not be subject to appeal before any court.

44. *Comment* — Shareholders can usually bargain among themselves to arrive at an efficient operating document or shareholders' agreement without resort to legally enforceable norms. However, there are circumstances in which, due to information asymmetries or other contracting infirmities, parties are unable to rely upon provisions that deal with dissension and deadlocks. Moreover, these provisions may be insufficient to cover the full range of contracting circumstances. This often leaves minority shareholders unprotected and vulnerable to oppression. In this case, the role of courts plays a central role in completing contracts ex post. Despite the beneficial effects of such judgments, reliance on judicial intervention is not always an effective means of conflict resolution. Not only could ex post intervention be imprecise, but it also tends to involve significant transaction costs and is time-consuming. Moreover, some commentators point to large variations in judicial decision-making, supporting the view that judicial intervention is sometimes inconsistent and costly in redistribution terms. More significantly, while intra-firm conflicts may be observable to the shareholders of a simplified business entity, they may not be easily verifiable by judges, and even less so when personal relationships in the family or between friends are involved.

45. Nevertheless, as noted above, fiduciary duties may play a role in preventing oppression and supplementing the entity's organizational structure. But open-ended fiduciary duties in markets with less experienced courts and legal systems may prove less effective. The duty of loyalty, for instance, provides an important safety mechanism to protect investors against the abusive tactics of controlling shareholders. From the perspective of some legal traditions and in emerging markets, however, these duties are not easily enforceable unless they are clearly enunciated as formal legal rules.

46. In this regard, alternative dispute resolution procedures can serve to protect minority investors in simplified business entities. Naturally, shareholders are expected to resort to these alternative mechanisms if other gatekeeper institutions are insufficient (note that this is clearly the case in non-listed companies). Since the draft MLSBE allows shareholders great flexibility in choosing how to operate their business, they may also bargain ex ante to provide exit provisions that assist in the

resolution of any disputes or deadlocked issues. In order to assist the shareholders in drafting effective exit provisions, enacting States may consider the inclusion of model operating agreements as an annex to the simplified business entity statute. For instance, the operating document could contain provisions regarding the change of control in one of the shareholders.

Article 39. Governing law

The simplified business entity shall be governed by:

(a) This law;

(b) The formation document; and

(c) The operating document.

United Nations A/CN.9/WG.I/WP.90

General Assembly

Distr.: Limited
19 February 2015

Original: English

United Nations Commission on International Trade Law
Working Group I (MSMEs)
Twenty-fourth session
New York, 13-17 April 2015

Observations by the Government of the Federal Republic of Germany

Note by the Secretariat

The Government of the Federal Republic of Germany has submitted to the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) the following observations in order to provide the Working Group with additional information for its deliberations. The text of the observations is reproduced as an annex to this note in the form in which it was received by the Secretariat, with formatting changes.

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Annex

Observations by the Government of the Federal Republic of Germany

1. Working Group I has, so far, engaged in extensive deliberations on the possible simplification of the registration and incorporation of micro, small and medium-sized business entities. It has become apparent through the twenty-second and twenty-third sessions of Working Group I that a business cannot be separated from its national economic and cultural context. Many countries that take a very liberal approach to business incorporation provide for certain checks and balances outside their company law, namely through business-related regulations on work, banking and insolvency. Other jurisdictions historically consider a company to be governed to a far greater extent by their respective commercial and companies acts, for instance through ex ante preventive measures of justice.

2. In addition, the range of business entities addressed by the mandate, from the most micro to medium-sized entities, poses difficult questions with regard to the level of sophistication of possible provisions for incorporation globally. Extensive contractual freedom might be problematic in countries where founders of business entities lack the education or access to legal counsel to make best use of such freedom. It might also present difficulties in areas where ex post-only provisions against misuse of limited liability pose possible problems for those states seeking to strike a balance between the rights of entrepreneurs and the rights of their creditors, be they voluntary or involuntary creditors.

3. The efforts undertaken by Working Group I have been fruitful in the sense that such aspects have become apparent and have been discussed in great honesty. The Delegation of the Federal Republic of Germany, motivated to further nurture this discussion, would like to present the following seven theses to the Working Group as a possible way forward:

(i) *Building bridges*: In order to bridge gaps between different legal traditions in terms of business incorporation, there might be a need to build the bridge from both sides of the issue. The Secretariat's suggestion to use neutral language and, where possible, explore alternative solutions to existing models might be a powerful tool to find global answers to old questions.

(ii) *Honouring what is already there*: Each and every nation member of the Commission and, more so, every nation member of the United Nations, has a company act. There might be a possible need for amendment of these acts, as seems fit to these nations. A possible UNCITRAL instrument might have an important impact on fuelling such reform. But there is also possible danger that, in fact, the Working Group might be engaging in redundant work for many countries. Globally speaking, innovative ideas for business formalization might be the best offer to make.

(iii) *"Think small first"*: It has been made clear in the Working Group that many countries understand the mandate to be growth-oriented. But "thinking small first" is not necessarily contradictory to growth and cross-border trade, especially in terms of the media and services sectors. Catering to the needs of single-member

business entities, to sole traders or business network contracts is as likely to enhance growth as is providing for extensive legal provisions designed for future expansion of multiple business partners. In many developing countries, however, limiting the possible legal burdens as much as possible might be a necessary step to enhance formalization in the first place.

(iv) *Simple, cheap and trusted*: Finding a way to set up businesses simply, at a low or minimal cost and in a way that fosters trust by business partners, the banking sector, as well as the public, including tax offices and authorities involved in public procurement, will most likely help to boost formalization. However, company law alone will not suffice; the economic and regulatory environment for micro, small and medium-sized enterprises needs to be shaped accordingly.

(v) *Making limited liability work*: Registration is not merely an administrative process; it should perform legal functions, as the gateway to legality of all business entities above a certain level of complexity. With regard to limited liability, registration should, to the best extent possible, cater to reliable company ownership transparency, preferably performing ex ante checks on the information provided by companies.

(vi) *Making information available across borders*: In a globalized economy where not only the small do business with the big, but there is also a rising demand for international sustainable suppliers among smaller businesses, global access to relevant company information needs to be timely, accurate and up to date.

(vii) *Legislative guide with optional model provisions*: If the Working Group should choose to embark on an effort to prescribe a more innovative path to registration and incorporation of business entities, as suggested above, it should be aware that treading new ground never assures instant success. That being said, as a means of guiding new solutions globally and in the spirit of the best thinking in terms of financial inclusion and economic development, it is recommended that the Working Group formulate its suggestions as a work-in-progress document, allowing legal scholars, lawmakers and the business sector to contribute and enhance such work over time with the aim of achieving the best possible solutions.